

ST 02-22

Tax Type: Sales Tax

Issue: Responsible Corporate Officer – Failure to File or Pay Tax

**STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
CHICAGO, ILLINOIS**

**THE DEPARTMENT OF REVENUE
OF THE STATE OF ILLINOIS**

v.

**JOHN DOE, as
Responsible Officer of
ABC Factory Outlet,**

TAXPAYER

No. 00-ST-0000

NPL # 0000

IBT # 0000-0000

**Kenneth J. Galvin
Administrative Law Judge**

RECOMMENDATION FOR DISPOSITION

Appearances: Mr. JOHN DOE, appearing *pro se*, Mr. George Foster, appearing on behalf of the Department of Revenue of the State of Illinois.

Synopsis:

This matter comes on for hearing pursuant to JOHN DOE's (hereinafter "John") protest of Notice of Penalty Liability No. 0000 (hereinafter the "NPL"), as responsible officer of ABC Factory Outlet (hereinafter "ABC"). The NPL represents a penalty liability for Retailers' Occupation Tax of ABC due to the Department for the months of December, 1990, through September, 1991. A hearing was held in this matter on May 22, 2002, with John and Mr. Jim Doe (hereinafter "Jim"), John's brother, providing oral testimony. Following submission of all evidence and a review of the record, it is recommended that the NPL issued against John be finalized as issued. In support thereof, the following "Findings of Fact" and "Conclusions of Law" are made.

Findings of Fact:

1. The Department's *prima facie* case, inclusive of all jurisdictional elements, is established by the admission into evidence of NPL No. 0000, which shows a penalty for tax liability of ABC in the amount of \$18,081.37 including interest calculated through September, 1991. The NPL covers the months of December, 1990, through September, 1991. Tr. pp. 13-14; Dept. Ex. No. 1.
2. The State of Illinois' "Domestic Corporation Annual Report" for ABC for 1991 lists John as "Secretary" and Jim as "President." Jim signed the form on March 21, 1991. Tr. pp. 29-30; Dept. Ex. No. 3.
3. ABC's "NUC-1 Illinois Business Registration," lists John as "Secretary" and Jim as "President." On question 12 of the form, Jim accepted responsibility for the filing of returns and the payment of taxes due." Tr. pp. 30-32; Taxpayer's Ex. No. 1.
4. John and Jim each held 50% of the stock in "Best Business Machines" d/b/a ABC. Tr. pp. 43-44.
5. During the period covered by the NPL, John was an authorized check signer for ABC and signed checks. Tr. pp. 22, 46.
6. ABC's "ST-1, Sales and Use Tax Returns," for the periods October 1 through December 31, 1990, April 1, 1991 through June 30, 1991, July 1, 1991 through August 31, 1991, and September, 1991, were signed by John on February 8, 1992. Tr. pp. 24-25; Dept. Ex. Nos. 5, 6, 7, and 8.
7. On October 30, 1992, John and Jim signed an "Installment Contract" with the Department for unpaid sales taxes. The contract was for \$5,592, with a down payment of \$1,707 and future payments of \$350/month. Tr. pp. 23-24; Dept. Ex. No. 4.

8. John and Jim shared responsibility for the payment of bills and for accounting and bookkeeping during the period covered by the NPL. Tr. p. 45.
9. During the period covered by the NPL, utility bills including gas and electric, and the manager's salary were paid. Tr. pp. 46-47, 49.
10. Uniform Commercial Code financing statements filed with Bank were signed by Jim. A letter from ABC, dated September 10, 1990, authorizing the establishment of the outlet store, is addressed to Jim. A letter from ABC setting up the opening inventory of the outlet store is addressed to Jim. A proposal for insurance coverage for the outlet store, dated October 11, 1990, from Insurance Services, Ltd. is addressed to Jim. Tr. pp. 54-58; Taxpayer's Ex. Nos. 4, 5, 6 and 7.

Conclusions of Law:

The sole issue to be decided in this case is whether JOHN DOE should be held personally liable for the unpaid retailers' occupation tax of ABC. The statutory basis upon which any personal liability is premised is Section 13½ of the Retailers' Occupation Tax Act, which provides in relevant part:

Any officer or employee of any corporation subject to the provisions of this Act who has the control, supervision or responsibility of filing returns and making payment *** and who willfully fails to file such return or to make such payment to the Department or willfully attempts in any other manner to evade or defeat the tax shall be personally liable for a penalty equal to the total amount of tax unpaid by the corporation, including interest and penalties thereon; The Department shall determine a penalty due under this Section according to its best judgment and information, and such determination shall be prima facie correct and shall be prima facie evidence of a penalty under this Section.

Ill. Rev. Stat., ch. 120, par. 452½ (1987).

It is clear under Section 13½ that personal liability will be imposed only upon a person who: (1) is “responsible” for filing corporate tax returns and/or making the tax payments; and (2) “willfully” fails to file and/or pay such taxes.¹

I conclude, based on the testimony and evidence admitted at the evidentiary hearing, that John was a responsible party under the statute. In determining whether an individual is a responsible person, the courts have indicated that the focus should be on whether that person has significant control over the business affairs of the corporation and whether he or she participates in decisions regarding the payment of creditors and disbursal of funds. Monday v. United States, 421 F. 2d 1210 (7th Cir. 1970), *cert. denied*, 400 U.S. 821 (1970). Liability attaches to those with the power and responsibility within the corporate structure for seeing that the taxes are remitted to the government. *Id.*

John was a 50% shareholder in “Best Business Machines” doing business as ABC. Tr. p. 44. John is listed on the “NUC-1, Illinois Business Registration” as “Secretary.” Taxpayer’s Ex. No. 1. John is also listed as “Secretary” on the State of Illinois “Domestic Corporation Annual Report,” for 1991. Dept. Ex. No. 3. With regard to the NUC-1, John testified as follows: “I had no knowledge of my name being put there. I never signed this, never saw this and never accepted it.” Tr. p. 31. With regard to his position as “Secretary,” John testified that he never knew that he was a corporate officer until he received copies of documents from the Department, related to this case, where his name was listed. Tr. p. 19.

¹ Prior to January 1, 1994, Section 13½ of the Retailers’ Occupation Tax Act governed the assessment of personal tax penalties against responsible corporate officers or employees. However effective January 1, 1994, the penalty provision of Section 13½ was replaced by Section 3-7 of the Uniform Penalty and Interest Act (35 ILCS 735/3-7). Here the taxes accrued from December, 1990 through September, 1991, while Section 13½ was in effect. On the other hand, the NPL was not issued until December 28, 1994. Thus, a question arises as to whether Section 13½ or Section 3-7 controls the case at hand. In Sweis v. Sweet, 269 Ill.App.3d 1, 12 (1995), it was held that the penalty provision “in effect at the time the tax was incurred” should be applied. In accordance with this holding, I conclude that Section 13½ is controlling.

Although John admitted that he had check signing authority, he testified that he signed checks “only when [Jim] instructed me to do so, and to me it made sense since I lived close by the store.” Tr. p. 20. The ability to sign checks is a significant factor in determining whether a person is a responsible party because it generally comes with the ability to choose which creditors are paid. Gold v. United States, 506 F. Supp. 473 (E.D.N.Y. 1981), aff’d, 671 F. 2d 492 (2d Cir. 1982). Regardless of the circumstances under which John signed the checks, each time he signed, he participated in “decisions regarding the payment of creditors and the disbursal of funds,” evidencing his status as a responsible party. Monday, *supra*. John could have written a check for taxes. John testified that, until February, 1992, he was unaware that sales taxes and other taxes were not being paid. At that time, according to John, Jim handed him 25 to 30 unopened envelopes from the Department of Revenue and the IRS regarding unpaid taxes and told John to bring them to the accountant. Tr. pp. 18-19.

John’s testimony is refuted point by point by Jim’s testimony. According to Jim, he and John had “equal responsibility” for paying bills during the taxable period. Both did the accounting and bookkeeping and both were authorized check signers during the period. Tr. pp. 45-46. Jim testified that John signed “50% of the checks during the taxable period.” Tr. p. 46. Jim also stated that John was aware that sales taxes were not being paid during the taxable period. Both John and Jim received mail at ABC and Jim testified that he was “sure” that John had seen the late tax notices. Tr. p. 48. Jim stated that he discussed the “matter of the unpaid tax liability” with John during the period covered by the NPL. Tr. pp. 47, 48. Jim was asked the following question:

Q. During the - - JOHN DOE testified that in approximately February of '92 that you handed him a large stack of notices

from the Department of Revenue indicating unpaid taxes for the taxable period. And he testified that you, he had never previously seen those and you had never previously shown those to him; is that true ?

A. No.
Tr. p. 47.

Jim was subpoenaed for the evidentiary hearing by the Department and John chose not to cross-examine him.

The admission into evidence of the NPL establishes the Department's *prima facie* case with regard to both the fact that John was a "responsible" officer and the fact that he "willfully" failed to file and/or pay. Branson v. Department of Revenue, 168 Ill. 2d 247, 262 (1995). Once the Department established a *prima facie* case, the burden shifted to John to overcome the presumption of liability through sufficient evidence that he was either not a responsible officer or employee, or that his actions were not willful. *Id.*

In order to overcome the Department's *prima facie* case, the taxpayer must present evidence which is consistent, probable and identified with the corporation's books and records. Central Furniture Mart, Inc. v. Johnson, 157 Ill. App. 3d 907 (1st Dist. 1987). The only evidence presented by John at the hearing were documents addressed to Jim showing that Jim participated in the management of ABC. These documents included financing statements signed by Jim, letters from ABC to Jim establishing the outlet store and setting up the opening inventory, and a proposal for insurance coverage addressed to Jim. Taxpayer's Ex. Nos. 4, 5, 6, and 7. These documents do not show that John is not a responsible party. They do indicate that responsibilities at ABC were shared between John and Jim, as Jim credibly testified to. In any corporation, there may be more than one responsible party. Monday, supra. The statute does not confine liability to only one person in the corporation or to the person most responsible. Ill. Rev. Stat., ch. 120, par. 452½ (1987).

Without any documentary evidence to support his contentions, John has failed to rebut the Department's presumption that he was a responsible party under the statute. John's testimony alone is not sufficient to rebut the Department's *prima facie* case. Assuming, *arguendo*, that John had rebutted the presumption that he was a responsible party, the Department came back with credible testimony from Jim refuting, point for point, John's testimony. John then chose not to cross-examine Jim. The purpose of cross-examination is to obtain the truth. Marut v. Costello, 34 Ill. 2d 125 (1966). In choosing not to cross-examine Jim,

John allowed Jim's testimony to remain unchallenged in the record. Based on Jim's unrefuted testimony and the lack of documentary evidence supporting John's contentions, I must conclude that John has failed to overcome the Department's *prima facie* case that he was a responsible party of ABC.

John's signature on the "ST-1, Sales and Use Tax Returns" for ABC are further evidence of his status as a responsible party. On February 8, 1992, John signed ST-1's for December 31, 1990, April 1 through June 30, 1991, July 1 through August 31, 1991, and September 30, 1991, all periods included in the NPL. Dept. Ex. Nos. 5, 6, 7 and 8. John testified that the accountant prepared all of the tax returns and "instructed me to sign them and contact the Department for a payment schedule." Tr. p. 19. John testified that he did not understand that by signing the ST-1's, he was then becoming a responsible party for the period of time covered by the statements. Tr. p. 37. "My biggest failure with all of this apparently was listening to the accountant and signing the returns for the period that I was not in control of or aware of." Tr. p. 20. It is important to note that Jim's unchallenged testimony refutes John's lack of involvement in the outlet store and John's lack of knowledge of the late taxes. Tr. pp. 45, 47. John did not call the accountant or the outlet store manager to testify at the evidentiary hearing.

On October 30, 1992, John and Jim signed an "Installment Contract" with the Department for unpaid retailers' occupation tax of \$5,592.68, paying \$1,707.00 down. John signed his name as "Secretary," apparently realizing, at this time, the significance of his position in the corporation. Dept. Ex. No. 4. John testified that after he signed the ST-1's, he "opened up a separate account at the bank as a savings account escrow type of an account to put money aside for tax payments." Tr. p. 37. "[John] removed the checkbook and instructed the store manager to report to me from that moment on." Tr. p. 19. "From the day that I took over the ABC Factory Outlet I feel that I did then become the responsible party and I became willful." Tr. p. 37.

As discussed previously, I have concluded that John failed to rebut the Department's *prima facie* case that he was a responsible party of ABC during the period covered by the NPL. Assuming, *arguendo*, that he was not responsible during the accrual of the taxes, he became a responsible party when he signed the ST-1's. John even admits that he became a responsible party when he took over the outlet. Tr. p. 37. If an individual becomes a responsible party at some point after the tax liability has accrued, he is still responsible in the amount of the corporation's funds and liquid assets at the time he assumed responsibility. Purdy Co. of Illinois v.

United States, 814 F. 2d 1183 (7th Cir. 1987), citing Slodov v. United States, 436 U.S. 238 (1978). Moreover, the taxpayer has the burden of establishing the lack of available funds and liquid assets. Sinder v. United States, 655 F. 2d 729 (6th Cir. 1981).

No documentary evidence was admitted at the hearing showing what assets or money was available at the time John admitted he began operating ABC. No documentary evidence was admitted showing that John demanded an accounting from Jim or made any attempt to correct Jim's alleged mismanagement of ABC. No documentary evidence was admitted showing any attempt by John to retain enough money in the bank, by court order if necessary, to cover the existing sales tax liability that he took responsibility for when he signed the ST-1's. I have concluded previously that John was a responsible party during the entire period covered by the NPL. However, even if he became a responsible party for the first time in February, 1992, when he signed the ST-1's, he is still liable for ABC's unpaid sales tax.

The second and remaining element which must be met in order to impose personal liability is the willful failure to pay the taxes due. The Department presents a *prima facie* case for willfulness with the introduction of the NPL into evidence. Branson v. Dept. of Revenue, 168 Ill.2d 247 (1995). The burden, then, is on the responsible party to rebut the presumption of willfulness.

Section 13½ fails to define what constitutes a willful failure to pay or file taxes. *Id.* at 254. In attempting to clarify what constitutes a willful failure to file or pay taxes, the courts have adopted a broad interpretation of the words "willfully fails." Department of Revenue ex rel. People v. Corrosion Systems, Inc., 185 Ill. App. 3d 580 (4th Dist. 1989). Under this broad interpretation, responsible officers are liable if they delegate bookkeeping duties to third parties and fail to inspect corporate records or otherwise fail to keep informed of the status of the retailers' occupation tax returns and payments. Branson, *supra* at 267. Willfulness also includes "failure to investigate or to correct mismanagement after having notice that withholding taxes have not been remitted to the Government." Peterson v. United States, 758 F. Supp. 1209 (N.D. Ill. 1990). A person acts willfully in failing to pay delinquent taxes if he prefers other creditors to the State. Department of Revenue v. Heartland Investments, 106 Ill. 2d 19 (1985).

John attempted to rebut the presumption of willfulness by testifying that he was not involved in the day to day operations of ABC, that he was not aware of the status of the sales tax returns, and further, that Jim was responsible for the payment of taxes. This testimony was refuted point for point by Jim's unchallenged testimony. Assuming, *arguendo*, that John's testimony was true, it would not rebut the presumption of willfulness. John was a 50% shareholder in ABC. He had the authority to write checks and in the 10-month period covered by the NPL, he wrote checks and could have written a check for taxes. If John abdicated the responsibility for the payment of taxes to Jim, this would not be a valid defense. A responsible person cannot escape his obligation to ensure that taxes are paid by delegating the responsibility to others. Wright v. United States, 809 F.2d 425 (7th Cir. 1987).

John testified that as of February, 1992, he was on notice that sales taxes had not been remitted to the State. Tr. pp. 18-19. At that time, John signed the ST-1's for the periods included in the NPL. John testified that he then set up a separate bank account to put aside money for tax payments, he "removed" the checkbook, and instructed the store manager to report to him from then on. Tr. p. 37. "From the day that I took over the ABC Factory Outlet I feel that I did then become the responsible party and I became willful." Tr. p. 37. John testified that he "quit working for Jim Doe in January of 1994 after working for him for 22 years." Tr. p. 20.

There was a two-year period, from February, 1992, through January, 1994, when John admits that he was the financially responsible party for ABC. No evidence was admitted at the hearing to show what assets or money was available to ABC at the time John admitted that he began operating the business. In the two year period that John admits responsibility, the sales taxes that John had signed for remained unpaid. I must conclude that whatever measures John took, as the financially responsible party for ABC, were insufficient or ineffective to correct ABC's mismanagement, further exhibiting willfulness. Although John testified that he left

ABC in January, 1994, no evidence was admitted showing if he received a distribution of assets, as a 50% shareholder, at the time he left.

Finally, Jim testified that during the period covered by the NPL, other bills were being paid:

- Q. Now, during that period some bills were being paid though; that is correct, isn't it?
- A. Basic utility bills.
- Q. And the manager's salary was paid?
- A. Correct. Yes.
- Q. And during the taxable period, the rent, electric and gas were paid; is that correct?
- A. Correct.
- Tr. p. 46.

Jim was asked whether John was aware during the taxable period that utilities and the manager's salary were being paid, while sales taxes were not being paid. Jim responded: "I would assume so." Tr. p. 49. In his testimony, John did not bring up the payment of other expenses while sales taxes were not being remitted. John did not cross-examine Jim and, accordingly, Jim's testimony regarding the preference of other creditors over the State is unchallenged in the record. Without any testimony or documentary evidence from John as to the payment of creditors, and knowing that the State was not paid its sales taxes, I must conclude that other creditors were preferred over the State further showing willfulness on John's part. Accordingly, John has failed to rebut the Department's *prima facie* presumption that he willfully failed to pay ABC's sales taxes.

WHEREFORE, for the reasons stated above, it is my recommendation that Notice of Penalty Liability No. 0000 be finalized as issued

ENTER:

August 19, 2002

Kenneth J. Galvin
Administrative Law Judge